Canada Revenue Agency: How to Avoid This Wealth-Destroying TFSA Pitfall!

Description

The investment gains and dividends within your Tax-Free Savings Account (TFSA) are free from taxation, making the vehicle an incredibly powerful way to accumulate wealth over prolonged periods of time.

The wealth-creative powers to be had with regular TFSA contributions and tax-free compounding (or dividend reinvestment) could allow one to snowball their wealth to unfathomable heights over the course of decades.

And while the TFSA is a seemingly simple and invaluable tool for all Canadians, it's also important to follow the rules that come with its use to avoid getting caught offside with the Canada Revenue Agency (CRA).

There's a strict rule set that TFSA users must follow

If one breaks the rules, they put themselves at risk of overcontributing.

As you may know, Canadians are granted a set amount that they're allowed to contribute to a TFSA. For those who've yet to contribute and were of age since the TFSA's inception in 2009, the cumulative amount will be $69,500 in 2020.

If you're like many Canadians who've lost track of their contributions, you could be at risk of overcontribution, and the longer you remain above your TFSA limit, the stiffer your penalties could become. And don't think for a second that the taxman won't eventually find out if you've been deliberately overcontributing or have been aggressively guesstimating your contribution room.

The CRA charges 1% per month on any "TFSA excess amounts." While the 1% may not seem like much, it could be a very harsh penalty if you've overcontributed by a considerable amount and have left it like that for an extended period of time.

Not to scare you, but the consequences of overcontributing have the potential to be quite severe.

Fortunately, there's no need to panic if you think you may be at risk of overcontributing if you don't know the TFSA withdrawal rules by heart.

If you've lost track of how much room you've got left or if you're at risk of overcontributing, you can simply check with the CRA to see precisely how much room you're under or over the limit. And if you're over, just make the necessary withdrawals and limit your potential penalties.

It's better to be safe than sorry!

If you're like many Canadians who use their TFSAs as a passive-income stream with popular high yielders like **H&R REIT**, it can be easy to lose track of your withdrawals and contributions over the years. And if you accidentally re-contributed the amount of your withdrawal within the same year, you could have impacted your contribution room for the current year.

So, if you find that cash moves in and out of your TFSA frequently, it can save you a fortune in penalties to double-check with the CRA, either by phone or through the online portal, to ensure you're not going over the limit and to get a precise amount that you're able to contribute at any given time.

The last thing you want is for stiff penalties to nullify the wealth-creative effects made possible by tax-free compounding within a TFSA. Given how ridiculously simple it is to check your contribution room, there really are no excuses for ball-parking a contribution amount unless you haven't been contributing regularly in the past and know for certain that you've got ample room available.

Don't risk the TFSA overcontribution penalties; it's just not worth it.

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